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The Manufacturers Hanover
Financial Digest
Economic Commentary, Selected Financial Data, and Business Indicators

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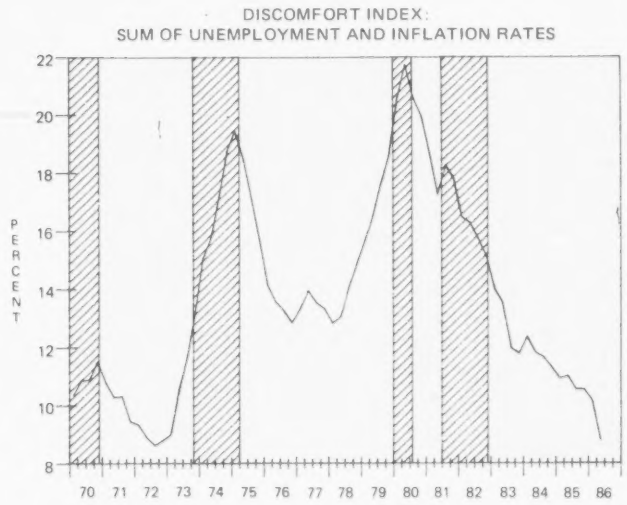
With The Consumer At The Throttle . . .

The scant 0.1 percent increase in retail sales during July, coupled with the downward revision in June's figure, has once again raised questions about the ability of the consumer sector to keep the economy expanding for the rest of this year and into 1987. For even more than usual, the U.S. economy is being driven by consumer spending. During the first half of 1986, real personal consumption accounted for nearly all of the $58 billion increase in real domestic demand (real GNP less net exports). In the second quarter of 1986, real consumer spending bolted upward at close to a six percent seasonally adjusted annual rate, compared with the anemic 1.1 percent rise in the overall economy. However, recent statistics that suggest weakness in retail sales as well as in housing and incomes, plus the continuing decline of manufacturing and mining employment, have economists asking: Can the consumer keep spending?

A look at employment, incomes and inflation, probably the best gauges of consumer economic well-being, would seem to justify expectations that the consumer sector can—and will—continue to increase spending over the next few quarters. The unemployment rate returned to 6.9 percent in July, and the employment rate—the percentage of the adult population with jobs—now stands at a record 60.8 percent. Total employment crossed the 111.5-million-worker mark for the first time ever in July, paced by job increases in service-producing industries and construction.

Overall personal income growth did soften in May and June, but this weakness was caused by two nonrecurring events: a drop-off in subsidy payments to farmers and a strike by communications workers. Excluding these two factors, personal incomes during May and June would have increased by $24.5 billion instead of falling by nearly $6 billion.

More good news comes from the inflation front. Consumer prices were down during the first six months of 1986, enabling consumers to enjoy increased buying power from their take-home pay. Because of this, the discomfort index—the unemployment rate plus the inflation rate—plummeted also. In the second quarter of 1986, it averaged 8.81 percent—the lowest level in almost 14 years (see chart).



. . . The Expansion Remains On Track . . .

Households are also improving their financial positions. Financial assets during the fourth quarter of 1985 and the first quarter of 1986 grew at a seasonally adjusted annual rate of 23.5 percent, due mainly to a rapid buildup of mutual fund deposits. Household liabilities, on the other hand, rose only at an 11.5 percent annual rate during this same period, as consumers began to rein in their use of credit, a trend that is still continuing. In the first half of 1986, consumers took on only $32.2 billion in installment credit—the smallest six-month increase in three years.

June's rise in consumer credit was a modest $5.1 billion—due mainly to growth in automobile credit which was enhanced by financing incentives. Credit extended by retailers decreased during the month, and the fall in gasoline prices caused credit outstanding at gasoline companies to drop $109 million. By better managing their funds, consumers have vastly improved their balance sheets. According to

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the Federal Reserve, households now hold $3.26 in financial assets for every $1 of liabilities, the highest such ratio since 1976.

One factor that heightened worries about a consumer-spending slowdown was the drop in housing starts in May and June. Since housing construction is considered a prime catalyst for the economy, concerns arose that this sector was beginning a downturn that could affect other areas of business. However, despite the two consecutive monthly drops, starts for the first half of 1986 are still running 11.5 percent above the comparable period of last year. Moreover, sales of new single-family homes for the first six months of 1986 are 18 percent above last year's January-June period, and the percent of families surveyed who are planning to buy a new home within the next six months is still strong. Both the national median sales price and the mortgage rate for a new home decreased in June. This raised the proportion of families who can afford to purchase a new home to 37 percent from only 23 percent two years ago.

. . . As Long As Imports Don't Derail It

Certainly, there are some signs that all is not perfect in the consumer sector. For one thing, the economy is not growing evenly across the U.S. For example, West Virginia and Mississippi have battled high unemployment during this expansion. The severe problems of the energy sector have boosted

Selected Federal Reserve Data

(Averages of Daily Figures--Billions of Dollars)

	Week Ending 8/13/86	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	193.407	+ .550	+16.802
Loans to Depository Inst.	.812	+ .107	− .332
Float	.402	− .907	− .170
Total Reserve Bank Credit	211.366	+ .039	+19.827
Treasury Deposits with Federal Reserve Banks	3.695	+ .171	+ .663
Currency in Circulation	201.386	+ .779	+13.049
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	155.491	+ 1.597	+31.054
	8/13/86		
Member Bank Reserves:			
Total Reserves Held	50.470	+ .531	+ 7.322
Excess (Deficiency)	.589	− .518	− .149
Net Free Reserves	.203	− .496	− .054
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (8/4/86)	679.6	+ 18.2‡	+ 13.3‡
M2 (July '86)	2,697.1	+ 11.6	+ 8.1
M3 (July '86)	3,358.5	+ 8.4	+ 7.9
Domestic Nonfinancial Debt (1st Q'86)	7,033.5	+ 8.7	+ 14.2

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Four-week moving average.

New York Money Market

Offering Rates 8/15/86	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.56%	5.53%	5.62%
* Federal Agencies	5.73	5.70	5.72
* Municipal Notes–High Grade (46% Taxable Equivalent)	7.87	8.33	8.80
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	5.98	5.95	6.10

‡Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	6.13%	Sep.	6.12%
15- 29 days	6.13	Oct.	6.00
30- 59 days	6.10	Nov.	5.90
60- 89 days	6.02	Dec.	5.81
90-179 days	5.88	Jan.	5.78
180-239 days	5.75	Feb.	5.74
240-270 days	5.75		

‡Industrial Paper–Prime		†Federal Funds Effective Rate	6.40%
30- 89 days	6.08%		
90-120 days	5.98		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'86	$ 4,182	$ 4,149	$ 3,965
Gross National Product (1982 Dollars)*	2nd Q'86	$ 3,666	$ 3,656	$ 3,568
Percent Change, Annual Rate	2nd Q'86	1.1	3.8	2.3
Change in Consumer Prices*	Jun '86	6.0%	2.4%	2.4%
Change in Producer Prices*	Jul '86n	− 4.8%	0.0%	2.4%
Civilian Employment (Thousands of Persons) †	Jul '86	109,882	109,673	106,871
Unemployment as % of Civilian Labor Force†	Jul '86	6.9%	7.1%	7.3%
Personal Income*	Jul '86	$ 3,479	$ 3,476	$ 3,305
Leading Indicators Composite Index (1967=100)†	Jun '86	178.6	178.1	167.7
Industrial Production Index (1977=100) †	Jul '86n	124.1	124.2r	124.1
Net Change in Consumer Installment Credit †	Jun '86n	$ 5.07	$ 6.46r	$ 4.39
U.S. Merchandise Trade Balance	Jun '86	−$ 14.17	−$ 13.12	−$ 10.50
Plant and Equipment Expenditures*	3rd Q'86	$388.87(a)	$387.42(a)	$388.90
Private Housing Starts (Thousands of Units)*	Jun '86	1,845	1,860	1,693
New Construction Expenditures*	Jun '86	$ 375.1	$ 374.9	$ 352.9
Total Business Inventories †	Jun '86n	$ 589.0	$ 586.7r	$ 580.1
Total Business Sales †	Jun '86n	$ 423.6	$ 421.6r	$ 418.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

unemployment rates in Louisiana and Alaska to double-digit levels. The heat wave and drought in the Southeast continue to destroy crops, poultry and livestock in that region. For another, despite the slowdown in debt accumulation, consumer credit outstanding remains at record levels both in absolute terms and as a percent of disposable income. And the uncertainty of tax reform has postponed certain consumer buying decisions, especially in housing and other credit-related purchases.

On the whole, however, concerns should not center on whether U.S. consumers will continue to spend. The average consumer is still able to increase his or her expenditures. The more important worry is from what source this demand will be satisfied. As long as the nation's trade deficit remains large, increased consumer spending will not necessarily translate into a more robust rate of output for the U.S. economy. Indeed, the $20.4 billion increase in the real net export deficit used to determine real GNP during the second quarter of 1986 subtracted more than two percentage points from the nation's overall growth rate. And although consumers increased their nominal-dollar purchases of durable goods by 5.8 percent in the second quarter of 1986 compared to the second quarter of 1985, output of consumer hardgoods by U.S. factories rose only 2.3 percent in the same period. This gap between demand and production was satisfied by a 17.3 percent surge in U.S. imports of consumer durable goods. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (7/30/86)	153,430	+ 188	– 317
New York City (8/6/86)	33,480	+ 154	+ 754
Commercial Paper (8/6/86)	318,128	+ 2,876	+48,815

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/30/86)	256,799	+ 20	+ 1,594
New York City (8/6/86)	56,572	+ 812	– 3,636

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/30/86)	736,321	+ 719	+ 50,209
New York City (8/6/86)	157,934	– 215	+ 9,585

Financial Markets

	Friday 8/15/86	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.70%	– .13	– 1.64
180-Day Bills†	5.76	– .22	– 1.89
Longest Bills†	5.93	– .14	– 2.03
Recent Issues:			
6⅝s 7/31/88	6.31	– .18	
7¼s 6/15/90	6.67	– .18	
7⅜s 5/15/96	7.13	– .16	
7¼s 5/15/16	7.28	– .13	
Municipals:			
Bond Buyer–20 Bond Index* (8/14/86)	7.33%	– .20	– 1.79
Blue List Total ($ Million)	$2,268	–$ 95	+ $ 277
30-Day Visible Supply ($ Million)	$3,182	–$1,571	– $1,327
Total	$5,450	–$1,666	– $1,050
Corporates:			
Moody's Aa Composite (8/14/86)	9.23%	– .10	– 2.26
30-Day Visible Supply ($ Million)	$2,221	–$ 824	+ $ 613
Stocks:			
Dow-Jones Averages:			
Industrials	1,855.60	+ 72.98	+ 542.88
Transportation	756.00	+ 43.12	+ 89.22
Utilities	211.24	+ 7.24	+ 54.03
65 Stocks	718.42	+ 30.98	+ 175.76
N.Y.S.E. Composite Index	142.22	+ 5.81	+ 34.30
N.Y.S.E. Avg. Daily Vol. for Week (000's)	132,330	+ 4,464	+ 48,664

* 46% Taxable equivalent 13.57%.

† Bond equivalent.

International Rates

	Friday 8/15/86	Week Ago
EURODOLLAR DEPOSIT RATES (bid)		
Overnight	6.31%	6.31%
1 month	6.19	6.38
3 month	6.06	6.31
6 month	6.06	6.31
1 year	6.12	6.44
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	7.46%	7.62%
Long Term (7 to 15 yrs.)	8.06	8.15

FOREIGN EXCHANGE SPOT RATES

New York Opening (8/15/86)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02336	42.80
Canada	.7196	1.3896
Denmark	.1285	7.7825
France	.1489	6.7175
Germany	.4839	2.0665
Italy	.0007030	1422.50
Japan	.006487	154.15
Mexico	.001476	677.50
Netherlands	.4296	2.3280
Switzerland	.6008	1.6645
U.K.	1.4950	.6689

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